

**REPORT OF THE AUDIT OF THE
MORGAN COUNTY
SCHOOL DISTRICT**

**For The Fiscal Year Ended
June 30, 2012**

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Members of the Board
Morgan County School District
West Liberty, Kentucky

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying basic financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Morgan County School District, West Liberty, Kentucky, as of and for the year ended June 30, 2012, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and the audit requirements prescribed by the Kentucky State Committee for School District Audits in Office of Management and Budget Circular No. A-133, Audits of States, Local Governments, and Non-Profit Organizations, Appendix I to the Independent Auditor's Contract - General Audit Requirements, Appendix II to the Independent Auditor's Contract - State Audit Requirements, Appendix III to the Independent Auditor's Contract - Audit Extension Request, and Appendix IV to the Independent Auditor's Contract - Instructions for Submission of the Audit Report. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Morgan County School District, as of June 30, 2012, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 8 and 35 through 36 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and

INDEPENDENT AUDITOR'S REPORT

(Continued)

other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Morgan County School District's basic financial statements as a whole. The introductory section and combining and individual non-major fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual non-major fund financial statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is also not a required part of the basic financial statements of the Morgan County School District. The combining and individual non-major fund financial statements and the schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Ross and Company", is written over a horizontal line.

Ross and Company, PLLC
November 8, 2012

**Morgan County School District
West Liberty, Kentucky
Management's Discussion and Analysis (MD & A)
Year Ended June 2012**

As management of the Morgan County School District (District), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended June 30, 2012. We encourage readers to consider the information presented here in conjunction with additional information found within the body of the audit.

FINANCIAL HIGHLIGHTS

- The beginning fund balance for fund 1 for the District was \$2,152,880 which includes Site Based CWFD in the amount of \$11,085 and restricted sick leave in the amount of \$167,960. The CWFD amount was re-budgeted in the per pupil accounts for designated schools. The ending fund balance for fund 1 was \$5,695,717, which includes committed Site Based CWFD in the amount of \$13,558 and will be budgeted appropriately for FY 2013. This ending fund balance amount is inflated due to insurance reimbursement to the district for tornado related losses. The FY12 fund balance also included \$131,123 for current portion of restricted sick leave liability. The General Fund currently has \$1,575,000 invested in CD's.
- The General Fund had \$18,794,630 in revenue, which primarily consisted of the state program (SEEK), property, utility, motor vehicle taxes, Universal Service Fund reimbursement and insurance reimbursement in the amount of \$3,541,466. There was \$15,254,845 in General Fund expenditures including \$321,400 in tornado related expenses and inter-fund transfers in the amount of \$22,138 to the Technology fund. Also, included within this amount is \$131,123 budgeted for sick leave with an actual of \$21,204 paid out and long term sick leave liability reflected in the notes to the financial statements.
- On March 2, 2012 an EF 3 tornado did considerable damage to the county and school district. District losses included: Central Office building, Gateway building, one bus, three vehicles, football locker facility, press box, concession stand, bleachers, lights and fencing at football and tennis complexes. There was also considerable damage to West Liberty Elementary School, football field and tennis courts. The fate of West Liberty Elementary has yet to be determined as negotiations continue with the insurance company.
- Work continues on the new Wrigley Elementary School. The project is estimated to be completed by December, 2013 with a revised BG-1 cost of \$15,074,905.
- The district continued utilizing the remaining American Recovery and Reinvestment Act (ARRA) monies through Title I and IDEA in the amount of \$104,256 to support salaries. Also supporting eight positions was \$377,500 in remaining Education Jobs Fund monies.
- The cost of diesel /gasoline fuel for the district actually increased by \$37,660 from last year due the continuing increase of rates for fuel. The General fund absorbed fuel cost (0699-fuel reimbursement code) in the amount of \$104,527 for athletic and academic trips which decreased by \$13,527 from last year. The cost for fuel would be considerably higher if PTO's and Fund 2 grants did not continue supporting this excessive cost.
- The board also supplements various other areas including health nurses/supplies \$90,925; Speech Therapy \$63,480; Physical Therapy \$11,896; Occupational Therapy \$20,920; Gifted and Talented \$3,225; Technology \$11,101; Band \$4,981; Athletics (MCHS/MCMS) \$12,295; Academics (MCMS/MCHS) \$2,505; Vocational \$7,500; Textbooks \$3,567 and Academic Based/District/Regional/National \$14,528. The combined total of all of these programs was \$186,961 less than budget of \$432,925.

FINANCIAL HIGHLIGHTS (CONTINUED)

- The overall utilities reflected a decrease of \$46,644 in the district from last year. Decreased electricity usage per KEEPS energy program continues to reflect savings for the district in the amount of \$11,803.
- The Kentucky Retirement Systems notified the district of an increase in the employer contribution for CERS (classified staff) from 16.93 percent for FY11 to 18.96 percent for FY12 which cost the district an additional \$84,845. Kentucky Teachers' Retirement (certified staff) employer contributions continue to increase. Per law, KTRS employer contributions will increase in increments until it reaches 3% by FY 2016 (FY 2012--.5%; FY 2013--1.0%, FY 2014--1.5%, FY 2015--2.25%, FY 2016--3.0%).
- Bonds are issued as the District renovates facilities consistent with a long-range facilities plan that is established with community input and in keeping with Kentucky Department of Education (KDE) stringent compliance regulations. Four new buses were purchased this year and final payments were made on Series 2001 and KISTA TECH new market tax credit program with the combined KISTA payments decreasing by \$14,931. The notes to the financial statements reflect liability for KISTA technology and bus leases per paying agents for the district. The paying agent for buses is Monticello Banking Company \$146,740; Bank of New York \$41,228 and U.S. Bank for technology in the amount of \$35,563 for FY12.

OVERVIEW OF FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements comprise three components: 1) district-wide financial statements, 2) fund financial statements, and 3) notes to financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

District-wide financial statements. The district-wide financial statements are designed to provide readers with a broad overview of the District's finances in a manner similar to a private-sector business.

The statement of activities presents information showing how the District's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

The statement of activities presents information showing how the District's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The district-wide financial statements outline functions of the District that are principally supported by property taxes and intergovernmental revenues (government activities.) The governmental activities of the District include instruction, support services, operation and maintenance of plant, student transportation and operation of non-instructional services. Fixed assets and related debt is also supported by taxes and intergovernmental revenues.

The district-wide financial statements can be found on pages 9 and 10.

Fund financial statements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. This is a state mandated uniform system and chart of accounts for all Kentucky public school districts utilizing the MUNIS administrative

OVERVIEW OF FINANCIAL STATEMENTS (CONTINUED)

software. The District used fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the District can be divided into three categories: governmental, proprietary and fiduciary funds. Fiduciary funds are trust funds established by benefactors to aid in student education, welfare and teacher support. The only proprietary funds are the day care and food service operations. All other activities of the District are included in the governmental funds.

The basic governmental fund financial statements can be found on pages 11 and 13.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the district-wide and fund financial statements.

The notes to the financial statement can be found on pages 20-34.

DISTRICT-WIDE FINANCIAL ANALYSIS

Net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$19,733,677 as of June 30, 2012.

A portion of the District's net assets reflects its investment in capital assets (e.g., land and improvements, buildings and improvements, vehicles, furniture and equipment and construction in progress); less any related debt used to acquire those assets that are still outstanding. The District used these capital assets to provide services to its students; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The District's financial position is the product of several financial transactions including the net results of activities, the acquisition and payment of debt, the acquisition of capital assets, and the depreciation of capital assets.

Net Assets for the period ending June 30, 2012 and 2011, respectively:

| ASSETS | 2012 | 2011 |
|---|----------------------|----------------------|
| Total current assets | \$ 19,619,502 | \$ 4,609,382 |
| Total non-current assets | 22,679,456 | 20,761,526 |
| Total assets | <u>\$ 42,298,958</u> | <u>\$ 25,370,908</u> |
| LIABILITIES | | |
| Total current liabilities | \$ 2,529,107 | \$ 1,706,514 |
| Total non-current liabilities | 20,036,174 | 9,381,180 |
| Total liabilities | <u>\$ 22,565,281</u> | <u>\$ 11,087,694</u> |
| NET ASSETS | | |
| Invested in capital assets, net of related debt | \$1,596,491 | \$ 10,508,218 |
| Restricted | 13,166,961 | 2,301,385 |
| Unrestricted | 4,970,225 | 1,473,611 |
| Total net assets | <u>19,733,677</u> | <u>14,283,214</u> |

Please see the Table 1 below and Table 2 on page 7, which present comparison summaries of revenues and expenses for the current fiscal year ended and the previous year FY2011.

MORGAN COUNTY SCHOOL DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS
June 30, 2012
(Continued)

Table 1

| | General Fund | | Special Revenue | | Food Service | |
|---|---------------------|-------------------|------------------------|------------------|---------------------|------------------|
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Revenues/Sources: | | | | | | |
| Local Revenue Sources | \$ 2,500,894 | 2,361,899 | \$ 54,425 | 49,378 | \$ 233,639 | 284,604 |
| State Revenue Sources | 12,630,202 | 11,811,475 | 617,249 | 641,950 | 237,479 | 242,622 |
| Federal Revenue Sources | 70,686 | 58,034 | 2,755,618 | 3,900,728 | 985,453 | 935,531 |
| Fund Transfer | 48,052 | 46,460 | 22,138 | 46,070 | - | - |
| Other | 3,547,848 | 2,432 | - | - | - | - |
| Totals | <u>\$18,797,682</u> | <u>14,280,300</u> | <u>\$ 3,449,430</u> | <u>4,638,126</u> | <u>\$ 1,456,570</u> | <u>1,462,757</u> |
| Expenditures/Expenses: | | | | | | |
| Instruction | \$7,928,706 | 7,084,622 | \$2,417,134 | 3,612,478 | \$ - | \$ - |
| Student Support Services | 751,486 | 778,090 | 162,693 | 157,249 | - | - |
| Instructional Staff Support Services | 505,627 | 504,700 | 397,625 | 368,811 | - | - |
| District Admin Support | 617,385 | 439,926 | 2,525 | - | - | - |
| School Admin Support | 915,520 | 918,308 | 97,773 | 65,634 | - | - |
| Business Support Services | 452,895 | 367,206 | 26,558 | 44,089 | - | - |
| Plant Operation & Management | 2,278,503 | 2,146,220 | 4,240 | 5,054 | - | - |
| Student Transportation | 1,498,085 | 1,372,686 | 18,486 | 26,264 | - | - |
| Food Service Operation | - | - | - | 7,422 | 1,480,576 | 1,449,945 |
| Community Services | 20,107 | 22,280 | 322,396 | 346,125 | - | - |
| Land Improvements | 5,277 | - | - | - | - | - |
| Debt Service | 223,531 | 238,463 | - | - | - | - |
| Fund Transfer | 22,138 | 42,832 | - | 5,000 | - | - |
| Totals | <u>15,254,845</u> | <u>13,915,332</u> | <u>3,449,430</u> | <u>4,638,126</u> | <u>1,480,576</u> | <u>1,449,945</u> |
| Excess of Revenues Over Expenditures | <u>\$ 3,542,837</u> | <u>\$ 364,967</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ (24,005)</u> | <u>\$ 12,812</u> |

**Note This Table does not include beginning balances or depreciation expenses but does reflect on-behalf payments made by KDE. The chart does not include Fund 54 (Community Education). Fund 54 started with \$680 with additional revenues of \$210 and had expenditures totaling \$795 for FY12.*

Comments on Budget Comparisons

- The District's total General Fund revenue for the fiscal year ended June 30, 2012, excluding on-behalf payments, were \$18,094,159 including a beginning balance of \$2,152,880.
- General fund budget expenditures to actual varied from line item to line item with the ending actual expenditures being \$1,622,996 less than budget by 11.58% favorable percentage points.

FY-2012 Summary Revenue/Expenditures

Fund 1-General Fund

The majority of revenue was derived from State Revenue (67%) with local funding making up (13%) of total revenue. These percentages of revenue funds are skewed due to the other local revenue source (19%) which was inflated from insurance money related to the tornado. The greatest amount of revenue is spent on

FY-2012 Summary Revenue/Expenditures (Continued)

Fund 1-General Fund (Continued)

instruction expenditures. This makes up 52% of the actual budget. The instruction function includes the SBDM expenditures for staff and supplies. The student support services make up 5% which includes attendance services, guidance counseling, health services, psychological testing; speech, hearing, and vision services. The instructional staff support makes up 3% which includes staff support personnel and librarians. The district administration support makes up 4% which includes workers comp, sick leave pay for retirees, contingency, property insurance, tax collection fees, and superintendent's office expenses. The school administration support makes up 6% which includes principals and secretaries expenses. The business support services makes up 3% which includes the finance office and other central office expenditures. The plant operation and management makes up 15%. The student transportation makes up 10%. Community services makes up less than 1% which includes activities concerned with providing services to students, staff, or the community which are not considered instructional. Debt service makes up 1% from which KISTA payments for buses are made.

Fund 2-Special Revenue Fund

The majority of revenue was derived from federal sources 80% with the state revenue making up 18% and the remaining 2% derived from local sources. The function with the greatest expenditure is instruction being 70%.

Fund 51-Food Service Fund

Revenue is received from local, state, and federal monies. The largest being federal which makes up 67%, state 16%, and local 16% of the budget. Fund 51 (food service) currently maintains a C.D. in the amount of \$50,000 and restricted sick leave budgeted in the amount of \$3,051. Proprietary funds consist of food service and Fund 54 (Community Ed). Fund 54 ended the year with a balance of \$95.

| Table 2 | Capital Outlay | | FSPK | | Construction Fund | |
|---|-----------------------|--------------------|-------------------|----------------------|--------------------------|---------------------|
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Revenues: | | | | | | |
| Local Revenue Sources | \$ - | \$ - | \$ 190,440 | \$ 191,629 | \$ - | \$ - |
| State Revenue Sources | 188,599 | 184,284 | 474,123 | 470,885 | - | - |
| Fund Transfers | - | - | - | - | 76,148 | 1,664,033 |
| Other | - | - | - | - | 13,141,208 | - |
| Totals | \$ 188,599 | \$ 184,284 | \$ 664,563 | \$ 662,514 | \$ 13,217,356 | \$ 1,664,033 |
| Expenditures: | | | | | | |
| Plant Operation Management | \$ 27,318 | \$ - | \$ - | \$ - | \$ - | \$ - |
| New Bldg Construction | - | - | - | - | 2,039,812 | 393,241 |
| Renovations | - | - | - | - | 707,880 | 53,090 |
| Debt Service | - | - | 401,665 | 402,900 | - | - |
| Fund Transfers | 124,200 | 248,027 | - | 1,460,704 | - | - |
| Totals | 151,518 | 248,027 | 401,665 | 1,863,604 | \$ 2,747,692 | 446,331 |
| Excess of Revenues Over Expenditures | \$ 37,081 | \$ (63,743) | \$ 262,898 | \$(1,201,090) | \$10,469,664 | \$1,217,702 |

FY-2012 Summary Revenue/Expenditures (Continued)

Fund 310 and Fund 320

Fund 310 is the Capital Outlay Fund and Fund 320 is the building fund (FSPK). State funding makes up the Capital Outlay and the Building Fund is made up of state and local revenue. During the FY12 school year FSPK funds were used to make bond payments on existing debt. Series 1998A (Morgan Co. High Gym and additions) was paid off during the fiscal year. Capital Outlay funds supported BG-1 maintenance replacement of gym lights at East Valley Elementary, Morgan County Middle School, and Morgan County High School in the amount of \$76,148. Property insurance payments for the district were also made in the amount of \$48,052.

Fund 360

This is the Construction Fund used for new building or renovations. The restricted fund balance for FY12 totals \$11,845,717. Included in this balance is \$10,328,326 from construction of the new elementary school which will replace West Liberty Elementary along with balances from prior and current BG-1's transferred from Capital Outlay for maintenance projects and insurance money related to tornado damages/losses in the district.

BUDGETARY IMPLICATIONS

In Kentucky the public school fiscal year is July 1-June 30; other programs, i.e. some federal operate on a different fiscal calendar, but are reflected in the district overall budget. By law the budget must have a minimum 2% contingency. Per PSD/CSD data submitted to Kentucky Department of Education certified staff decreased 6 and Classified 1 from last year. Due to the reduction in ADA and state revenue the districts' SEEK money continues to decrease in comparison to cost of operation for the district. SEEK is the district's major source of revenue. Another area of concern, we did not receive itemized documentation per KRS 160.500; OAG 74-595 for the 4% tax collection fee paid to the sheriff's department for FY12 and for previous years.

Questions regarding this report should be directed to the Finance Officer, Sharon Dye at (606) 743-8002 or by mail at Morgan County Board of Education, 212 University Drive, West Liberty, Kentucky 41472.

MORGAN COUNTY SCHOOL DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS

For the year ended June 30, 2012

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Morgan County School District (District), a five-member group, is the basic level of government, which has financial accountability and control over all activities related to the public school education within the jurisdiction of the Morgan County School District. The District receives funding from local, state and federal government sources and must comply with the requirements of these funding source entities. Board members are elected by the public and have decision-making authority, the authority to levy taxes, the power to designate management, the ability to significantly influence operations and have primary financial accountability for fiscal matters. The District is not included in any other governmental "reporting entity" as defined by GASB pronouncements. In accordance with GASB Standard 14, financial transactions of the following component unit are incorporated in the accompanying financial statements.

Morgan County School District Finance Corporation – The Morgan County School District resolved to authorize the establishment of the Morgan County School District Finance Corporation (a non-profit, non-stock, public and charitable corporation organized under the School Bond Act and KRS 273 and KRS 58.180) as an agency of the District for financing the costs of school building facilities. The Board Members of the Morgan County School District also comprise the Corporation's Board of Directors.

Basis of Presentation

District-wide Financial Statements

The statement of net assets and the statement of activities display information about the District as a whole. These statements include the financial activities of the primary government, except for fiduciary funds. The statements distinguish between those activities of the District that are governmental and those that are considered business-type activities.

The District-wide statement of activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the District and for each function or program of the District's governmental activities. Direct expenses are those that are specifically associated with a service, program or department and are therefore clearly identifiable to a particular program and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues are presented as general revenues of the District, with certain limited exceptions. The comparison of direct expenses with program revenues identifies the extent to which each business segments or governmental function is self-financing or draws from the general revenues of the District.

Fund Financial Statements

Fund financial statements report detailed information about the District. The focus of governmental and enterprise fund financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column. Non-major

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fund Financial Statements (Continued)

funds are aggregated and presented in a single column. Fiduciary funds are reported by fund type.

Fund Accounting

The accounts of the District are organized on the basis of funds or account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, reserves, fund balance, revenues and expenditures or expenses as appropriate. The various funds are summarized by type in the financial statements. The District uses the following funds:

Governmental Fund Types

General Fund - The General Fund is the primary operating fund of the District and accounts for all revenues and expenditures of the District not encompassed within other funds. All general tax revenues and other receipts that are not allocated by law or contractual agreement to some other fund are accounted for in this fund.

Special Revenue Funds – Special Revenue Funds are used to account for the proceeds of grants from local, state and federal revenue sources that are legally restricted to expenditures for specified purposes. Project accounting is employed to maintain integrity for the various sources of funds. Federally funded grant programs are identified in the Schedule of Expenditures of Federal Awards included in this report.

Capital Projects Funds are used to account for financial resources to be used for the acquisition and construction of major capital facilities and equipment.

Capital Outlay Fund - The Support Education Excellence in Kentucky (SEEK) Capital Outlay Fund receives those funds designated by the state as Capital Outlay Funds and is restricted for use in financing projects identified in the District's facility plan.

Building Fund - The Facility Support Program of Kentucky Fund (FSPK) accounts for funds generated by the building tax levy required to participate in the School Facilities Construction Commission's construction funding and state matching funds, as applicable. Funds may be used for projects identified in the District's facility plan.

Construction Fund- The Construction Fund is used to account for all resources including proceeds from bond sales and other revenues to be used for authorized construction expenditures.

Debt Service Funds are used to account for the accumulation of resources for and the payment of general long-term principal and interest related cost; and, for the payment of interest on general obligation notes payable, as required by Kentucky Law.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Proprietary Fund Type

Proprietary Funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of these funds are included on the balance sheet. Proprietary fund-type operating statements present increases (revenues) and decreases (expenditures) in retained earnings. Fixed assets of the proprietary fund are recorded at cost less accumulated depreciation. Depreciation on fixed assets is recorded using the straight-line method over the assets estimated useful lives. Under this basis of accounting and measurement focus, the District applies (a) all GASB pronouncements and (b) FASB Statements and Interpretations, APB opinions and Accounts Research Bulletins issued on or before November 30, 1989, except those that conflict with a GASB pronouncement. The District's Proprietary funds are comprised of the following:

The School Food Service Fund is used to account for school food service activities, including the National School Lunch Program, which is conducted in cooperation with the U.S. Department of Agriculture (USDA).

The Community Education Fund accounts for services rendered to the public. The fund also accounts for the services printing and copying.

Fiduciary Fund Type

Fiduciary fund financial statements use the current financial resources measurement focus and the modified accrual basis of accounting.

The School Activity Funds are fiduciary funds used to account for student activity organizations in accordance with the Uniform Program of Accounting for School Activity Funds. Financial statements of groups and organizations associated with the school system but not originated within the District (e.g., Band Boosters, Parent-Teacher Associations, etc.) are not included within school activity funds.

Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. Government-wide financial statements are prepared using the accrual basis of accounting. Governmental funds that are presented in the fund financial statements use the modified accrual basis of accounting. Proprietary and fiduciary funds use the accrual basis of accounting.

Exchange and Non-exchange transactions – There are two types of transactions: exchange and non-exchange. The method of determining revenue recognition (i.e., accrual v. modified accrual) depends upon the type of exchange as well as source of revenue. Exchange transactions occur when each party receives essentially equal value. Non-exchange transactions occur when one party receives value without directly giving equal value in return.

Modified Accrual - Revenue from non-exchange transactions (e.g., grants, entitlements and donations) must be available to be recognized. These sources of revenue are recognized in the fiscal year in which all eligibility requirements have been satisfied. Under the modified accrual basis of accounting, revenues from exchange transactions are recorded when susceptible to accrual, i.e., both

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Accounting (Continued)

measurable and available. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. For the District, “available” means within sixty days of June 30. Property tax revenue is recognized in the fiscal year for which the taxes are levied. Deferred revenue arises when assets are recognized before revenue recognition criteria have been satisfied. Grants and entitlements received before eligibility requirements are met are recorded as deferred revenue. Under the modified basis of accounting, expenditures are generally recognized in the accounting period in which the related fund liability is incurred, if measurable. Allocations of cost, such as depreciation, are not recognized in governmental funds.

Accrual - Under the accrual basis of accounting, revenues are recorded when an exchange takes place. Expenses are recognized at the time they are incurred.

Encumbrance Accounting

Encumbrances for goods or purchased services are documented by purchase orders or contracts. Under Kentucky Law, appropriations lapse at fiscal year end. Encumbrances outstanding at that time are to be either canceled or appropriately provided for in the subsequent year’s budget.

Cash and Cash Equivalents

For the purposes of the statement of cash flows, the proprietary fund type considers highly liquid investments with maturity of three months or less when purchased to be cash equivalents.

Inventories

The Proprietary Fund records inventory at cost, determined on a first-in, first-out basis, using the accrual basis of accounting.

Budget

The District is required by state law to adopt a budget annually for the General Fund and Special Fund. Each budget is presented on the modified actual basis of accounting which is consistent with the fund financial statement presentation with the exception of employee benefits paid by the state on behalf of the district. Such benefits are reported as expenditure in the General Fund financial statements based on labor distribution, but are not included in the annual budget.

Fund Balances

The School Board has implemented GASB Statement 54 employing new terminology and classifications for fund balance items.

Non-spendable Fund Balance includes amounts that are (a) not in spendable form, or (b) legally or contractually required to be maintained intact. The “not in spendable form” criterion includes items that are not expected to be converted to cash, for example: inventories, prepaid amounts, and long-term notes receivable. At June 30, 2012, the District did not have a non-spendable fund balance.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fund Balances (Continued)

Restricted fund balances arise when constraints placed on the use of resources are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. At June 30, 2012, the District had \$131,123 as restricted in General Fund for sick leave, \$11,845,717 as restricted capital projects in the Construction Fund, \$789,523 restricted in the Building Fund and \$55,297 restricted in the Capital Outlay Fund.

Committed fund balances are those amounts that can only be used for a specific purpose pursuant to constraints imposed by formal action of the government's highest level of decision-making authority, which, for the District is the Board of Education. The Board of Education must approve by majority vote the establishment (and modification or rescinding) of a fund balance commitment. The District had committed \$13,558 for Site Based CWFD in the General Fund June 30, 2012.

Assigned fund balances are those amounts that are constrained by the government's *intent* to be used for specific purposes, but are neither restricted nor committed. The Board of Education allows program supervisors to complete purchase orders which result in the encumbrances of funds. Assigned fund balance also include (a) all remaining amounts (except for negative amounts balances) that are reported in governmental funds, other than the general fund, that are not classified as non-spendable and are neither restricted nor committed and (b) amounts in the general fund that are intended to be used for a specific purpose. The district did not have any assigned fund balances

Unassigned fund balance is the residual classification for the general fund. This classification represents fund balance that has not been assigned to other funds and that has not been restricted, committed, or assigned to specific purposes within the general fund.

The District considers unrestricted amounts to have been spent when an expenditure is incurred for a purpose for which both restricted and unrestricted fund balance is available. Also, the District has established the order of assigned, committed, and restricted when an expenditures is incurred for purposes for which amounts in any of those unrestricted fund balance classifications could be used.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 2. SAFEGUARDING CASH AND CASH EQUIVALENTS

The District's cash and cash equivalents consist of amounts deposited in interest bearing accounts. The depository bank deposits for safekeeping and trust with the District's third party agent approved pledged securities to protect District funds on a day-to-day basis during the period of the contract. The pledge of approved securities is waived only to the extent of the dollar amount of Federal Deposit Insurance Corporation (FDIC) insurance.

NOTE 2. SAFEGUARDING CASH AND CASH EQUIVALENTS (CONTINUED)

At June 30, 2012, the carrying amount of the District's combined deposits (cash and cash equivalents) excluding school activity funds was \$14,396,289. The bank balances were covered by the combination of FDIC insurance and collateral held by the District's agent in the District's name at June 30, 2012.

Custodial Credit Risk – Deposits

Custodial Credit Risk is the risk that in the event of a depository institution failure, the Districts' deposits may not be returned. The District does not have a deposit policy for custodial credit risk but rather follows the requirements of KRS 41.240(4). All deposits meet current guidelines.

The cash deposits held at financial institutions can be categorized according to three levels of risk. These three levels of risk are as follows:

Category 1 Deposits that are insured or collateralized with securities held by the District or by its agent in the District's name.

Category 2 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent in the District's name.

Category 3 Deposits which are not collateralized or insured.

Based on these three levels of risk, all of the District's cash deposits are classified as Category 2.

Statutes authorize the District to invest in obligations of the U.S. Treasury and U.S. agencies, municipal securities and repurchase agreements. The investment pool and repurchase agreements are considered nonparticipating contracts. The District has a repurchase agreement whereby daily bank deposits sweep to an interest bearing overnight account. Such agreements can be categorized according to three levels of risk. These three levels of risk are:

Category 1 Investments that are insured or collateralized with securities held by the District or by its agent in the District's name.

Category 2 Investments that are collateralized with securities held by the pledging financial institution's trust department or agent in the District's name.

Category 3 Uninsured and unregistered investments held by the counter party, its trust or its agent, but not in the District's name.

The District's investment in repurchase agreements is classified by risk level as Category 2.

NOTE 3. PROPERTY TAXES

Property taxes collected are recorded as revenues in the fund for which they were levied. The District's ad valorem property tax is levied each October 1 on the assessed value listed as of the prior January 1 for all real and business personal property located in the District. The billings are considered due upon receipt by the taxpayer; however, the actual date is based on a period 30 days after the tax bill mailing. Property taxes collected are recorded as revenues in the fiscal year for which they were levied. All taxes collected are initially deposited in the General Fund and then transferred to the appropriate fund.

NOTE 3. PROPERTY TAXES (CONTINUED)

The property tax rates assessed for the year ended June 30, 2012, to finance the General Fund operations were \$.493 per \$100 valuation of real property, \$.493 per \$100 valuation for business personal property and \$.533 per \$100 valuation for motor vehicles.

The District levies a utility gross receipts license tax in the amount of 3% of the gross receipts derived from the furnishings, within the county, of telephonic and telegraphic communication services, cablevision services, electric power, water, and natural, artificial and mixed gas.

NOTE 4. RETIREMENT PLANS

Kentucky Teachers' Retirement System

The Kentucky Local School District contributes to the Teachers' Retirement System of Kentucky (KTRS), a cost-sharing, multiple employer defined benefit pension plan. KTRS administers retirement and disability annuities, and death and survivor benefits to employees and beneficiaries of employees of the public school systems and other public educational agencies in Kentucky. KTRS requires that members of KTRS occupy a position requiring either a four (4) year college degree or certification by KY Department of Education (KDE). Job classifications that permit experience to substitute for either of these requirements do not participate in KTRS.

KTRS was created by the 1938 General Assembly and is governed by Chapter 161 Section 220 through Chapter 161 Section 990 of the Kentucky Revised Statutes (KRS). KTRS issues a publicly available financial report that includes financial statements and required supplementary information for the defined benefit pension plan. That report can be obtained by writing to Kentucky Teachers' Retirement System, 479 Versailles Road, Frankfort, KY 40601 or from the KTRS web site at <http://www.ktrs.ky.gov/>.

Funding policy - Contribution rates are established by KRS. Members who established an account in a state retirement system before July 2008 are required to contribute 10.355% of their salaries to KTRS. Members after July 2008 contribute an additional 0.5%. The Commonwealth of Kentucky is required to contribute 13.105% of salaries for members in a state retirement system before July 1, 2008 and 14.105% of salaries for members who started their account after July 1, 2008. The federal program for any salaries paid by that program pays the matching contributions.

Medical Insurance Plan

Plan description - In addition to the pension benefits described above, Kentucky Revised Statute 161.675 requires KTRS to provide access to post-employment healthcare benefits to eligible members and dependents. The KTRS Medical Insurance benefit is a cost-sharing multiple employer defined benefit plan. Changes made to the medical plan may be made by the KTRS Board of Trustees, the Kentucky Department of Employee Insurance and the General Assembly.

To be eligible for medical benefits, the member must have retired either for service or disability. The KTRS Medical Insurance Fund offers coverage to members under the age of 65 through the Kentucky Employees Health Plan administered by the Kentucky Department of Employee Insurance. Once retired members and eligible spouses attain age 65 and are Medicare eligible, coverage is obtained through the KTRS Medicare Eligible Health Plan.

NOTE 4. RETIREMENT PLANS (CONTINUED)

Kentucky Teachers' Retirement System (Continued)

Funding policy – In order to fund the post-employment healthcare benefit, active member contributions are matched by the state at .75% of members' gross salaries. Those who became members before July 1, 2008 contribute 1.25% of salary to the plan. Member contributions are 1.75% of salary for those who became members after July 1, 2008. Also, the premiums collected from retirees as described in the plan description and investment interest help meet the medical expenses of the plan. Additionally, under the Shared Responsibility Plan, the local school district employers pay 0.5% of members' salary for the 2011-2012 fiscal year.

The Morgan County School District total payroll for the year was \$11,303,022. For the year ended June 30, 2012, the Commonwealth contributed \$860,687 to KTRS for the benefit of participating employees. The School districts contributions to KTRS for the year ending June 30, 2012 were \$275,718.

County Employees Retirement System

Plan Description - The County Employees Retirement System (CERS) administered by the Kentucky Retirement System (KRS) is a cost-sharing multiple-employer defined benefit public employee retirement system. The plan provides benefit pension plan coverage for substantially all regular non-certified, full-time employees of each county and Public Schools, and any additional eligible local agencies electing to participate in the System. The participant has a fully vested interest after the completion of sixty months of service, twelve of which are current service. At a minimum, terminated employees are refunded their contributions with credited interest at 3% compounded annually through June 30, 1980, 6% thereafter through June 30, 1986, and 4% thereafter.

CERS through KRS provides for retirement, disability, death, and survivor and health benefits of its members. The KRS annual financial report and other required disclosure information is available by writing the Kentucky Retirement System, 1260 Louisville Road, Frankfort, Kentucky 40601-6124, or by calling (800) 928-4646.

Funding Status and Progress - The Kentucky Retirement System administers CERS based upon employer matching contributions from each county, Public Schools and eligible local agencies electing to participate in the System. The Board of Trustees of Kentucky Retirement Systems determines contribution rates each biennium. The following are CERS non-hazardous contribution rates for the year ended June 30, 2012 member is 5% of their salaries. Participation after September 1, 2008 is at the rate of 6%. The District is required to contribute 18.96 %.

The District's total gross payroll for the year was \$12,446,024. The contribution requirement for CERS for the year ended June 30, 2012, was \$624,347, which consisted of \$480,660 from the District and \$143,687 from employees.

The contribution requirement for CERS for the year ended June 30, 2012, was \$693,475, which consisted of \$547,223 from the District and \$146,252 from employees.

Additional information and historical trend information can be obtained from the Teachers Retirement System of Kentucky and the County Employee Retirement System of Kentucky.

NOTE 5. LIABILITY FOR COMPENSATED ABSENCES

Employees are awarded a maximum of 10 days for 185-day contracts, 11 days for 11-month contracts, and 12 days for 12-month contracts of sick leave annually, based upon employment contract terms and District policy. Sick leave is accrued without limitation. Upon retirement from the school system, a certified and classified employee receives from the District an amount equal to 30% of the value of accumulated sick leave at the current daily rate of pay. At June 30, 2012, the estimate of the current portion for those employees with 27 or more years covered service is \$134,174, which is recorded as a current liability in the district-wide financial statements. The long-term portion is \$130,018, which is recorded as a non-current liability in the long-term district-wide financial statement.

NOTE 6. CAPITAL ASSETS

Capital assets are those assets not specifically related to activities reported in the proprietary funds. These assets generally result from expenditures in the governmental funds. These assets are reported in the governmental activities column of the government-wide statement of net assets but are not reported in the fund financial statements. Capital assets utilized by the proprietary funds are reported both in the business-type activities column of the government-wide statement of net assets and in the respective funds.

All capital assets are capitalized at cost or estimated historical cost and updated for additions and retirements during the year. Donated fixed assets are recorded at their fair market values as of the date received. The District maintains a capitalization threshold of \$5,000. The District does not possess any infrastructure. Improvements are capitalized; the cost of, normal maintenance and repairs that do not add to the value of the asset or materially extend an assets life are not.

All reported capital assets are depreciated. Improvements are depreciated over the remaining useful lives of the related capital assets. Depreciation is computed using the straight-line method over the following useful lives for both general capital assets and proprietary fund assets:

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MORGAN COUNTY SCHOOL DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2012
(Continued)

NOTE 6. CAPITAL ASSETS (CONTINUED)

| Governmental Assets | June 30, 2011 | Additions | Retirements | June 30, 2012 |
|---|----------------------|---------------------|---------------------|----------------------|
| Cost | | | | |
| Land | \$ 825,520 | \$ 263,500 | \$ - | \$ 1,089,020 |
| Land Improvements | 138,363 | - | (13,050) | 125,313 |
| Buildings & Improvements | 25,204,821 | 702,449 | (909,390) | 24,997,881 |
| Technology Equipment | 1,869,990 | - | (269,533) | 1,600,457 |
| Other | 4,060,263 | 99,096 | (572,673) | 3,586,686 |
| Vehicles | 3,142,259 | 373,046 | (240,876) | 3,274,429 |
| Construction in Progress | 489,489 | 2,352,519 | (489,489) | 2,352,519 |
| Totals at historical cost | 35,730,705 | 3,790,610 | (2,495,010) | 37,026,305 |
| Less: Accumulated Depreciation | | | | |
| Land Improvements | 6,528 | 6,380 | (394) | 12,514 |
| Buildings & Improvements | 8,487,696 | 525,186 | (748,183) | 8,264,699 |
| Technology Equipment | 1,430,629 | 167,320 | (266,534) | 1,331,415 |
| Other | 3,221,593 | 200,728 | (554,461) | 2,867,860 |
| Vehicles | 2,100,222 | 226,877 | (208,229) | 2,118,870 |
| Total accumulated depreciation | 15,246,668 | 1,126,491 | (1,777,801) | 14,595,358 |
| Net Fixed Assets - Government | \$ 20,484,037 | \$ 2,664,119 | \$ (717,210) | \$ 22,430,947 |
| Business Assets | | | | |
| Technology Equipment | \$ 7,102 | \$ - | \$ (1,039) | \$ 6,063 |
| General Equipment | 803,136 | 8,346 | (26,400) | 785,082 |
| Totals at historical cost | 810,238 | 8,346 | (27,439) | 791,145 |
| Less: Accumulated Depreciation | | | | |
| Technology Equipment | 3,171 | 1,213 | (1,039) | 3,345 |
| General Equipment | 529,578 | 35,639 | (25,926) | 539,291 |
| Total accumulated depreciation | 532,749 | 36,852 | (26,965) | 542,636 |
| Net Fixed Assets - Business Type | \$ 277,489 | \$ (28,506) | \$ (474) | \$ 248,509 |

| Description | Estimated Life in Years |
|----------------------------|--------------------------------|
| Buildings and Improvements | 25-50 |
| Land Improvements | 20 |
| Technology Equipment | 5 |
| Audi-Visual Equipment | 15 |
| Vehicles | 5-10 |
| Food Service Equipment | 10-12 |
| Furniture and Fixtures | 7 |
| Rolling Stock | 15 |

MORGAN COUNTY SCHOOL DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2012
(Continued)

NOTE 7. BOND DEBT

The District is required to make lease payments in amounts sufficient to satisfy debt service requirements on bonds issued by the Morgan County Public Board of Education Finance Corporation to construct school facilities. Current requirements for principal and interest expenditures are accounted for in the Building Fund in accordance with state law. The District is liable for all issues; however, School Facilities Construction Commission participates by contributing those portions of debt that are appropriated in the State's biennial budget.

Morgan County School District is contingently liable for the debt listed below under School Facilities Construction Commission (SFCC). The SFCC principal has not been included as bonded indebtedness in the basic financial statements. A Schedule of Total Bonded Debt Maturities follows on page 31.

The issue date, original amounts of the issue and interest rates are summarized below:

| <u>Bond Issue</u> | <u>Original Amount</u> | <u>Maturity Dates</u> | <u>Interest Rates</u> | 2011 | | 2012 | |
|--------------------------|-----------------------------------|----------------------------------|----------------------------------|---------------------------------------|-------------------------|---------------------------|---------------------------------------|
| | | | | <u>Outstanding Balance</u> | <u>Additions</u> | <u>Retirements</u> | <u>Outstanding Balance</u> |
| 1998 Series | 1,190,000 | 2012 | 5.15-5.60% | \$ 45,000 | \$ - | \$ 45,000 | \$ - |
| 2002A Series | 3,200,000 | 2015 | 3.50-4.35% | 1,805,000 | - | 410,000 | 1,395,000 |
| 2004 Series | 322,000 | 2024 | 2.75-5.00% | 234,000 | - | 14,000 | 220,000 |
| 2005 Series | 8,765,000 | 2026 | 3.75-4.00% | 7,225,000 | - | 345,000 | 6,880,000 |
| 2012 Series | 11,490,000 | 2032 | 2.00-3.50% | - | 11,490,000 | - | 11,490,000 |
| TOTAL | | | | \$ 9,309,000 | \$11,490,000 | \$ 814,000 | \$ 19,985,000 |

Assuming the issues are not called prior to scheduled maturity, the minimum obligations at June 30, 2012 for debt service are as shown in the supplemental Schedule of Total Bonded Debt Maturities, which includes "participation agreements" with the Kentucky School Facilities Construction Commission. The Kentucky General Assembly created the KSFCC for the purpose of assisting local schools in meeting school construction needs. The participation agreement amounts to be assumed by KSFCC are not recorded in the District's basic financial statements.

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NOTE 7. BOND DEBT (CONTINUED)

**MORGAN COUNTY SCHOOLS
SCHEDULE OF DEBT PAYMENTS
AS OF JUNE 30, 2012**

| YEAR | MORGAN COUNTY SCHOOL DISTRICT | | SCHOOL FACILITIES CONSTRUCTION | | TOTAL |
|-------|----------------------------------|-------------|-----------------------------------|-------------|--------------|
| | PRINCIPAL | INTEREST | PRINCIPAL | INTEREST | |
| 2013 | 401,298 | 285,470 | 592,702 | 332,579 | 1,612,049 |
| 2014 | 400,166 | 292,429 | 609,834 | 318,981 | 1,621,410 |
| 2015 | 414,112 | 278,249 | 596,888 | 298,563 | 1,587,812 |
| 2016 | 423,245 | 269,776 | 532,755 | 279,491 | 1,505,267 |
| 2017 | 433,463 | 260,566 | 548,537 | 261,272 | 1,503,838 |
| 2018 | 443,117 | 251,111 | 569,883 | 242,395 | 1,506,506 |
| 2019 | 452,187 | 241,433 | 586,813 | 222,839 | 1,503,272 |
| 2020 | 464,647 | 231,554 | 609,353 | 202,581 | 1,508,135 |
| 2021 | 476,237 | 219,201 | 628,763 | 180,265 | 1,504,466 |
| 2022 | 490,913 | 204,425 | 655,087 | 155,841 | 1,506,266 |
| 2023 | 504,754 | 189,134 | 677,246 | 130,482 | 1,501,616 |
| 2024 | 522,726 | 173,413 | 705,274 | 104,154 | 1,505,567 |
| 2025 | 534,817 | 157,144 | 710,183 | 76,722 | 1,478,866 |
| 2026 | 555,744 | 140,522 | 684,256 | 50,444 | 1,430,966 |
| 2027 | 568,785 | 124,423 | 161,215 | 35,194 | 889,617 |
| 2028 | 588,747 | 106,648 | 166,253 | 30,156 | 891,804 |
| 2029 | 608,427 | 87,808 | 171,573 | 24,836 | 892,644 |
| 2030 | 627,637 | 67,274 | 177,363 | 19,045 | 891,319 |
| 2031 | 646,651 | 46,091 | 183,349 | 13,059 | 889,150 |
| 2032 | 670,233 | 23,458 | 189,767 | 6,642 | 890,100 |
| TOTAL | \$10,227,906 | \$3,650,129 | \$ 9,757,094 | \$2,985,541 | \$26,620,670 |

NOTE 8. CAPITAL LEASE PAYABLE

The amount shown in the accompanying financial statements as lease obligations represent the Board's future obligations to make lease payments relating to equipment lease revenue bonds issued by the Kentucky Inter-local School Transportation Association ("KISTA") aggregating \$944,308 at June 30, 2012. These amounts are not reflected on the fund financial statements. The bonds issued to provide funds for the purchase of school buses and equipment, and the lease of these buses and equipment by the Board of KISTA is the source of the Board's obligation. Upon full payment of the lease, title will be conveyed to the Board.

NOTE 8. CAPITAL LEASE PAYABLE (CONTINUED)

| | 2011 | | | 2012 |
|---------------------------|-----------------------|-------------------------|---------------------------|-----------------------|
| | Outstanding | | | Outstanding |
| <u>KISTA Issue</u> | <u>Balance</u> | <u>Additions</u> | <u>Retirements</u> | <u>Balance</u> |
| 2001 | 17,391 | - | 17,391 | - |
| 2003 | 43,519 | - | 21,328 | 22,191 |
| 2006A | 147,729 | - | 29,739 | 117,990 |
| 2006B | 196,054 | - | 31,445 | 164,609 |
| 2008 | 106,782 | - | 14,528 | 92,254 |
| 2009 | 61,741 | - | 7,308 | 54,433 |
| New Market | 35,563 | - | 35,563 | - |
| 2011 | 335,529 | - | 36,287 | 299,242 |
| 2012 | - | 347,246 | - | 347,246 |
| TOTAL | \$ 944,308 | \$347,246 | \$193,589 | \$1,097,965 |

Shown below is a schedule by years of the future minimum lease payments under capital lease together with the present value of the net minimum lease payments as of June 30, 2012. Such leases are paid by the General Fund.

**MORGAN COUNTY SCHOOLS
SCHEDULE OF CAPITAL LEASE PAYMENTS
AS OF JUNE 30, 2012**

| <u>YEAR</u> | MORGAN COUNTY SCHOOL DISTRICT | | <u>TOTALS</u> |
|--------------------|--|------------------------|----------------------|
| | <u>PRINCIPAL</u> | <u>INTEREST</u> | |
| 2013 | 182,809 | 32,444 | 215,253 |
| 2014 | 159,724 | 26,995 | 186,719 |
| 2015 | 151,686 | 22,477 | 174,163 |
| 2016 | 150,093 | 17,975 | 168,068 |
| 2017 | 122,467 | 13,334 | 135,801 |
| 2018 | 91,482 | 9,665 | 101,147 |
| 2019 | 78,713 | 7,072 | 85,785 |
| 2020 | 66,567 | 4,822 | 71,389 |
| 2021 | 62,395 | 2,870 | 65,265 |
| 2022 | 32,029 | 841 | 32,870 |
| TOTAL | \$ 1,097,965 | \$ 138,495 | \$ 1,236,460 |

NOTE 9. OPERATING FUND TRANSFERS

The following transfers were made during the year:

| Type | From Fund | To Fund | Purpose | Amount |
|-----------------|----------------|-----------------|--------------------------|-------------------|
| Matching | General | Special Revenue | KETS Offer of Assistance | \$ 22,138 |
| Operating | Capital Outlay | General | Capital Fund Request | 48,052 |
| Operating | Capital Outlay | Construction | Capital Fund Request | 76,148 |
| Total Transfers | | | | <u>\$ 146,338</u> |

NOTE 10. DEFICIT OPERATING BALANCES

There are no funds of the District that currently have a deficit fund balance/net assets. However, the following funds have operations that resulted in a current year deficit of revenues over expenditures resulting in a corresponding reduction of fund balance/net assets:

| | |
|---------------------|------------|
| Food Service | (\$52,985) |
| Community Education | (\$585) |

NOTE 11. RISK MANAGEMENT

Liability Insurance Coverage

The District is exposed to various forms of loss of assets associated with the risks of fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, etc. Each of these risk areas is covered through the purchase of commercial insurance. The District has purchased certain policies, which are retrospectively rated which include worker's compensation insurance.

The District is exposed to various risks of loss related to limited torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District participates in the Kentucky School Boards Insurance Trust Liability Insurance Fund. These public entity risk pools operate as common risk management and insurance programs for all school districts and other tax supported educational agencies of Kentucky who are members of the Kentucky School Boards Association.

Worker's Compensation

The District pays an annual premium to each fund for coverage. Contributions to the Worker's Compensation Fund are based on premium rates established by such fund in conjunction with the excess insurance carrier, subject to claims experience modifications and a group discount amount.

Unemployment Insurance

The District obtains unemployment insurance coverage through the Kentucky School Boards Insurance Trust Unemployment Compensation Fund; however, the risk has not been transferred to such fund. In addition, the District continues to carry commercial insurance coverage for all other risk of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in the past three fiscal years.

NOTE 11. RISK MANAGEMENT (CONTINUED)

COBRA

Under COBRA, (Consolidated Omnibus Budget Reconciliation Act) employers are mandated to notify terminated employees of available continuing insurance coverage. Failure to comply with this requirement may put the District at risk for potential loss.

NOTE 12. COMMITMENTS AND CONTINGENCIES

Grant Programs

The District receives funding from federal, state and local government agencies. These funds are to be used for designated purposes only. For government agency grants, if the grantors' review indicated that the funds have not been used for the intended purpose, the grantors may request a refund of monies advanced, or refuse to reimburse the District for its disbursements. The amount of future refunds and unreimbursed disbursements, if any, are not expected to be significant. Continuation of the District's grant programs is predicated upon the grantor's satisfaction that the funds provided are being spent as intended and the grantor's intent to continue their programs.

NOTE 13. BUDGETARY DISCLOSURE REQUIREMENTS

Budgetary comparisons for the General Fund and Special Revenue Fund are disclosed as required supplementary information. "On behalf" contributions made by the Commonwealth of Kentucky were recorded in the District's records as revenues and expenditures. The purpose of the policy change was to conform to requirements of the GASB 34 reporting model. The District's budget appropriations did not reflect this change in policy.

NOTE 14. ON-BEHALF PAYMENTS

The District receives on-behalf payments from the State of Kentucky for items including retirement and insurance. The amount received for the fiscal year ended June 30, 2012 was \$3,816,349. These payments were recorded as follows:

| | |
|--------------|---------------------|
| General Fund | \$ 2,856,403 |
| Food Service | 206,060 |
| Debt Service | <u>753,885</u> |
| Total | <u>\$ 3,816,349</u> |

MORGAN COUNTY SCHOOL DISTRICT
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For the year ended June 30, 2012

NOTE A. BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal activity of the Morgan County Public Schools and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B. FOOD DISTRIBUTION PROGRAM

Non-monetary assistance is reported in the Schedule at the fair value of the commodities received. Commodities passed through the U.S. Dept. of Agriculture during the year totaled \$66,413.

MORGAN COUNTY PUBLIC SCHOOLS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the year ended June 30, 2012

Section 1. Summary of Auditor's Findings

Financial statements:

Type of auditor's report issued: unqualified

| | <u>Yes</u> | <u>No</u> |
|--|------------|-----------|
| Internal control over financial reporting | <u>X</u> | |
| • Material Weaknesses identified? | <u>X</u> | |
| • Significant Deficiencies identified that are not considered to be material weaknesses? | | <u>X</u> |
| • Noncompliance material to financial statements noted? | | <u>X</u> |

Federal Awards:

| | <u>Yes</u> | <u>No</u> |
|--|------------|-----------|
| Internal control over major programs | | <u>X</u> |
| • Material weakness identified? | | <u>X</u> |
| • Significant Deficiencies identified that are not considered to be material weaknesses? | | <u>X</u> |

Type of auditor's report issued on compliance for major programs: unqualified

| | <u>Yes</u> | <u>No</u> |
|---|------------|-----------|
| • Any audit findings disclosed that are required to be reported in accordance with section 510 (a) of Circular A-133? | | <u>X</u> |

Identification of major programs:

| <u>CFDA Numbers</u> | <u>Name of Federal Program or Cluster</u> |
|------------------------|---|
| 10.553, 10.555, 10.559 | Child Nutrition Cluster |
| 84.367 | Title II – Improving Teacher Quality |
| 84.410 | Education Jobs Fund Program |

- Dollar threshold used to distinguish between type A and type B programs \$300,000
- Auditee qualified as low-risk auditee? Yes _____ No X

MORGAN COUNTY PUBLIC SCHOOLS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the year ended June 30, 2012

Section 2. Financial Statement Findings

Current Year Findings:

2012-01: Fixed Asset

Statement of Condition: All fixed assets should be booked timely.

Criteria for Condition: All fixed assets should be booked timely to ensure proper and accurate recording of assets.

Cause of the Condition: Assets were not booked at time of audit.

Effect of the Condition: Unaudited financial statements were not accurately presented in regards to fixed assets.

Recommendation for Correction: Fixed assets that meet the board capitalization policy should be booked timely on a monthly basis at a minimum.

Response or Additional Information: Capitalized Fixed Assets will be booked timely, at least monthly. In a meeting with the Finance Officer and Fixed Assets Coordinator, a set of guidelines were developed to address separation of capitalized and inventory fixed assets. All fixed assets will be updated monthly and reviewed by the Finance Officer and Superintendent.

Prior Year Findings: No matters were reported

Section 3. Federal Awards Findings and Questionable Costs

Current Year Findings: No matters were reported

Prior Year Findings: No matters were reported

MORGAN COUNTY SCHOOL DISTRICT
SUMMARY OF PRIOR YEAR AUDIT FINDINGS
Year ended June 30, 2012

Prior Year Findings: No matters were reported

ROSS & COMPANY, PLLC
Certified Public Accountants
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Telephone (502) 499-9088
Facsimile (502) 499-9132

State Committee for School District Audits
Superintendent and Members of the Public Schools
Morgan County School District
West Liberty, Kentucky

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

We have audited the basic financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Morgan County School District, West Liberty, Kentucky, as of and for the year ended June 30, 2012, which collectively comprise the District's basic financial statements and have issued our report thereon dated November 8, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and the audit requirements prescribed by the Kentucky State Committee for School District Audits in accordance with Office of Management and Budget Circular No. A-133, Audits of States, Local Governments, and Non-Profit Organizations, Appendix I to the Independent Auditor's Contract - General Audit Requirements, Appendix II to the Independent Auditor's Contract - State Audit Requirements, Appendix III to the Independent Auditor's Contract - Audit Extension Request, and Appendix IV to the Independent Auditor's Contract - Instructions for Submission of the Audit Report.

Internal Control Over Financial Reporting

Management of Morgan County Public Schools is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Morgan County School District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Morgan County School District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and question costs, we identified certain deficiencies that we consider to be material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the financial

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS
(Continued)

statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described the accompanying schedule of findings and questions costs to be material weakness. 2012-01

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Morgan County School District's financial statements, are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards. In addition, the results of our tests disclosed no material instances of noncompliance of specific state statutes or regulation indentified in Appendix II of the Independent Auditor's Contract- State Audit Requirements.

We noted certain other matters that we reported to management of Morgan County School District in a separate letter dated November 8, 2012.

Morgan County School District's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the District's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the School District, management, others within the organization, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully Submitted,

A handwritten signature in cursive script, appearing to read "Ross and Company".

Ross and Company, PLLC
November 8, 2012

ROSS & COMPANY, PLLC
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State Committee for School District Audits
Superintendent and Members of the Public Schools
Morgan County School District
West Liberty, Kentucky

**INDEPENDENT REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

Compliance

We have audited Morgan County School District's compliance with the types of compliance requirements described OMB Circular A-133 Compliance Supplement that could have a direct and material effect on each of Morgan County School District's major federal programs for the year ended June 30, 2012. Morgan County School District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Morgan County School District's management. Our responsibility is to express an opinion on Morgan County School District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, Office of Management and Budget Circular No. A-133, Audits of States, Local Governments, and Non-Profit Organizations, Appendix I to the Independent Auditor's Contract - General Audit Requirements, Appendix II to the Independent Auditor's Contract - State Audit Requirements, Appendix III to the Independent Auditor's Contract - Audit Extension Request, and Appendix IV to the Independent Auditor's Contract - Instructions for Submission of the Audit Report. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Morgan County School District's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Morgan County School District's compliance with those requirements.

In our opinion, Morgan County School District complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each its major federal programs for the year ended June 30, 2012.

INDEPENDENT REPORT ON COMPLIANCE WITH REQUIREMENTS

APPLICABLE TO EACH MAJOR PROGRAM AND
ON INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133
(Continued)

Internal Control over Compliance

Management of Morgan County School District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Morgan County School District's internal control over compliance with requirements that could have a direct and material effect on a major federal program to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Morgan County School District's internal control over compliance.


A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider material weaknesses as defined above.

Morgan County School District's responses to findings identified in our audit, if any, are described in the accompanying schedule of findings and questioned costs. We did not audit Morgan County School District's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the audit committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully Submitted,


Ross & Company, PLLC
November 8, 2012

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State Committee for School District Audits
Superintendent and Members of the Public Schools
Morgan County School District
West Liberty, Kentucky

RECOMMENDATIONS AND COMMENTS TO MANAGEMENT

In planning and performing our audit, we considered Morgan County School District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Morgan County School District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be a material weakness.

Current Year Findings –

2012-01: Fixed Asset

Statement of Condition: All fixed assets should be booked timely.

Criteria for Condition: All fixed assets should be booked timely to ensure proper and accurate recording of assets.

Cause of the Condition: Assets were not booked at time of audit.

Effect of the Condition: Unaudited financial statements were not accurately presented in regards to fixed assets.

Recommendation for

Correction: Fixed assets that meet the board capitalization policy should be booked timely on a monthly basis at a minimum.

Response or Additional Information: Capitalized Fixed Assets will be booked timely, at least monthly. In a meeting with the Finance Officer and Fixed Assets Coordinator, a set of guidelines were developed to address separation of capitalized and inventory fixed assets. All fixed assets will be updated monthly and reviewed by the Finance Officer and Superintendent.

MORGAN COUNTY PUBLIC SCHOOLS
RECOMMENDATIONS AND
COMMENTS TO MANAGEMENT
JUNE 30, 2012
(Continued)

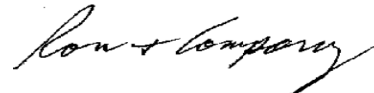
Prior Year Findings –

None

If any action occurs after this exit conference date, which affects the significant or material findings, it is the responsibility of management to provide that information to the auditors.

We sincerely appreciate the courtesy extended to our audit staff again this year. Of course, should you have any questions or concerns regarding your audit, please feel free to contact us.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Ross & Company", written in a cursive style.

Ross & Company, PLLC
November 8, 2012